



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201411039**

Release Date: 3/14/2014

Date: December 16, 2013

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Uniform Issue List:

501.04-00

501.32-00

501.32-01

501.33-00

Dear :

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code § 501(c)(4). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law, and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code § 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

This letter supersedes our letter dated December 3, 2013.

Sincerely,

Karen Schiller
Acting Director, Exempt Organizations
Rulings and Agreements



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: September 25, 2013

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend

Date 1 =
Date 2 =
State =
Form =
LLC =

Officer 1 =
Officer 2 =
Officer 3 =
\$x =
\$y =
\$z =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under section 501(c)(4) of the Code. The basis for our conclusion is set forth below.

FACTS:

You represent that you were formed in State on Date. On your Form 1024,

On your State Form, that you filed with the Secretary of State, you listed LLC as your sole sponsor. During your existence, LLC was your sole contributor.

In the narrative attached to your Form 1024, you represent that you were formed to qualify a veto referendum

To qualify the referendum, you began collecting enough signatures to place _____ on a ballot for the voters to either ratify it or reject it. In light of the passage of _____, you state, "However, the Committee decided to cease circulation of its referendum petitions and never turned in any of the executed petitions, which petitions it destroyed. It then ceased being a Committee on _____ by paying its debts and making a partial loan repayment to LLC."

During the time you were in existence, you were governed by three officers, Officer 1, Officer 2, and Officer 3. Officer 2 was the proponent of the referendum and the person responsible for its circulation and possible filing of the petitions. Officer 3 served as your treasurer and legal counsel. Although Officer 3 served as your treasurer, in the narrative attached to Form 1024, you state, "Officer 1 was the main decision maker on all expenditures." Further, you state, "campaign treasurers of committees with only one contributor are obviously required to spend committee money as the contributor decides, and Officer 1, the designated executive of LLC, approved in writing each expenditure of [yours], and Officer 3 then wrote and delivered the checks to the vendor."

You represent that had you remained in existence, you "might have solicited donations from individuals, businesses, community groups, trade associations, and/or other organizations which were interested in the issues promoted by the Committee." You indicate that you might have raised funds through several means, including primarily personal solicitations. However, you made no such attempts to raise funds.

In your submission dated _____, you state that LLC expected others to support you once the referendum qualified, but you ceased circulating petitions before a need for more funding.

The financial statement submitted with your Form 1024 states that your total revenue was \$x. You represent that \$y of this amount was a loan made to you by LLC, \$2,250,000 was a contribution by LLC and the remaining \$487 was from interest income.

Your financial statement lists expenditures that equal your total income. Of your expenditures, you list a payment of \$29,596 which you indicate is interest paid on what you characterize as a \$y loan from LLC. You also list an expenditure of \$637,000 which you identify as a "Partial Loan Repayment" to LLC. You state, "LLC originally loaned [you] \$y to commence the referendum qualification so that it could terminate that activity at any time and receive the unspent balance as a loan repayment."

In your submission dated _____, you state, "LLC received a partial loan repayment of \$600,000 from [you] on _____ and a second and final partial loan repayment of \$37,000 on _____. [You] terminated on _____ without repaying the \$z outstanding loan balance because it had no funds." Although you characterize the \$z as a

loan in your submission, on line 8, page 1, of your 2011 Form 990, you characterize the \$z, as a contribution.

In your submission dated , in response to our question regarding whether LLC expected full repayment of the \$y loan, you state,

"No. [You] operated as a 501(c)(4) and a State non-profit. Had [you] been debt free and had cash-on-hand when it terminated its referendum qualification activities after two months, State and federal non-profit law would have required [you] to spend that cash-on-hand for "charitable purposes" and not refund it to LLC, its sole Contributor. All large State make such loan agreements with their major contributors to be able to refund their unused contributions when their campaigning ends...since [your] application for exempt status was filed after all the non-profit's activities were already completed and all its money was raised, spent or refunded..."

You furnished a Revolving Credit Agreement (the "Agreement") between you and LLC which is effective as of . In the Agreement, LLC agrees to make loans to you from time to time on any business day during the period from the effective date of the Agreement to the date of the termination of the Agreement. Section C. of the Agreement defines "Loan Amount Outstanding" as the aggregate of all principal amounts extended by LLC to you. Section E. provides that you shall repay to LLC on the termination date the entire Loan Amount outstanding on such date. Although Section H. of the Agreement provides that LLC may by written notice cancel its commitment to issue any further obligations and/or demand from you the payment of the entire loan amount outstanding, it appears that no notice was provided nor was repayment demanded.

You submitted a copy of an incomplete, undated, and unsigned Request and Confirmation (the "Request") in which you requested, and LLC advanced, \$y. The interest rate was 2% compounded annually. The loan was unsecured and there was no date by which repayment was required.

LAW:

Section 501(c)(4) of the Code provides for the exemption from federal income tax of organizations not organized for profit but operated exclusively for the promotion of social welfare. Further, it provides that no part of the net earnings of such entity may inure to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(a)-1(c) provides that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Treas. Reg. § 1.501(c)(4)-1(a)(2) provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Rev. Rul. 73-306, 1973-2 C.B. 179 holds that an organization that is operated essentially for the private benefit of its members is not primarily engaged in activities for the common good and general welfare of the people of the community.

Rev. Rul. 80-107, 1980-1 C.B. 117, describes a membership organization open to individuals and institutions having a beneficial interest in shares of public utility companies. The organization was formed to expand the industry, create employment, increase scientific knowledge, and support the economic growth through the advancement of the interests of persons who invest in public utility stocks. In furtherance of its purpose, the organization prepares and files statements relating to rate and regulatory matters pending before the state public utilities commission and other state and federal regulatory agencies and legislative bodies. The revenue ruling holds that the primary beneficiaries of the organization's activities are its members, together with other individuals who own shares in the public utility companies of the state. Therefore, the organization is primarily operated to serve private interests rather than the interests of the community.

In *Commissioner v. Lake Forest, Inc.*, 305 F.2d 814 (4th Cir. 1962), a corporation was organized by World War II veterans for the purpose of purchasing a government housing project and converting it to cooperative, nonprofit housing for its members. Individuals became members in the corporation by purchasing an apartment unit and, as such, the number of members was limited to the number of units available. The court held that the organization was not described in section 501(c)(4) of the Code because it was "a public-spirited but privately-devoted endeavor" that provided only incidental benefit to the community. *Id.* at 818. The organization did not promote social welfare because it furnished housing only to a certain group of individuals, rather than on a community basis, and did not offer a service or program for the direct betterment or improvement of the community as a whole.

In *New York State Association of Real Estate Boards Group Insurance Fund v. Comm'r*, 54 T.C. 1325 (1970), an association organized by a small group interested in obtaining group insurance did not qualify for exemption because it offered its benefits to only a limited class of its members and their employees. The court noted "[t]here is not in such an organization the requisite civic concern to constitute social welfare" required for qualification under section 501(c)(4). Where the primary benefit from an organization is limited to that organization's members, and not provided to the community as a whole, the organization is not operated primarily for the social welfare.

In *Contracting Plumbers Cooperative Restoration Corporation v. United States*, 488 F.2d 684 (2d Cir. 1973), cert. denied 419 U.S. 827, 95 S. Ct. 47, 42 L. Ed. 2d 52 (1974), the court held that a cooperative organized by plumbers to repair cuts made in city streets by its members was not entitled to exemption as a civic league because it was organized by members who had substantial business interests in it, and each member enjoyed economic benefits precisely to the extent that he used and paid for the repair service.

In *Church of Eternal Life & Liberty v. Comm'r*, 86 T.C. 916 (1986), the court deduced from the exclusive control of the founder and major contributor over the assets and funds of the organization, together with a finding that the compensation to him was excessive, that the earnings inured to his private benefit.

United Cancer Council, Inc. v. Comm'r., 165 F.3d 1173 (7th Cir. 1999), holds that the inurement prohibition requires an organization not to siphon its earnings to its founder, or the members of its board or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager. The test is functional. It looks to the reality of control rather than to the insider's place in a formal organizational chart of an organization. The insider could be a mere employee or even a nominal outsider, such as a physician with hospital privileges in a charitable hospital.

In *Livernois Trust v. Comm'r.*, 433 F.2d 879 (6th Cir. 1970), the court considered payments by corporations to a trust that controlled them, recorded as a loan and evidenced by unsecured notes bearing 6% interest but on which no interest and no significant payments of principal had been paid to or demanded by the corporations. In determining whether or not the payments in fact constituted a bona fide loan, the court noted that "it is certain that the form of a transaction (here the duly executed 6% Notes) does not by itself control its nature, as opposed to the intent of the parties as demonstrated by the facts." *Id.* at 882. In addition, the court noted that "[w]hile in many cases various factors must be weighed in determining for income tax purposes the true character of a purported loan, there is one essential without which a transaction cannot be recognized as a loan. The parties must have entered into the transaction with the intention that the money advanced be repaid." *Id.* at 883 (internal quotation marks omitted). As factors indicating such an intent of repayment, the court listed "[n]ormal security, interest and repayment arrangements (or efforts to secure same)." *Id.* at 882. Finally, the court noted that related party transactions between a corporation and a party that controls it "are subject to the closest scrutiny." *Id.* at 881. Given that the trust receiving the funds controlled the corporation, the court noted that the parties' testimony that they intended the loans to be repaid had to "be viewed with some diffidence unless supported by other facts which bring the transaction much closer to a normal arms-length loan." *Id.* at 882. Because the notes were unsecured and no interest or significant payments of principal had been paid to or demanded by the corporations, the court affirmed the Tax Court's determination that the notes did not represent bona fide indebtedness.

ANALYSIS:

Private benefit:

Based on the information you submitted with your application, you are not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4) of the Code because your activities primarily serve private interests. Therefore, you do not qualify for exemption from federal income tax as an organization described in section 501(c)(4).

The concept of social welfare implies a service or program directed at benefiting the community as a whole, rather than a private group of individuals. See Rev. Rul. 73-306, Rev. Rul. 80-107 and *Commissioner v. Lake Forest, Inc.*, *supra*.

You state in your application that your primary purpose is to qualify a referendum

While you were in existence, the purpose of your activities was to benefit LLC by overturning legislation that adversely affected it. Thus, you operated in a manner similar to the organizations described in Rev. Rul. 73-306 and *Commissioner v. Lake Forest, supra*.

The organization described in Rev. Rul. 80-107, *supra*, claimed to be formed to expand the industry, create employment, increase scientific knowledge, and support the economic growth through the advancement of the interests of persons who invest in public utility stocks. However, the revenue ruling holds that the primary beneficiaries of the organization's activities are its members, together with other individuals who own shares in the public utility companies of the state. During the period that you were in existence, you operated in a manner similar to the organization described in Rev. Rul. 80-107. Although you state that you were formed to overturn legislation you claim is detrimental to jobs, investment and the state's economic future, LLC was the primary beneficiary of your activities. Any benefit to the community is incidental to the benefit to LLC. See also *Contracting Plumbers Cooperative Restoration Corporation v. United States, supra*.

Inurement:

You also do not qualify for exemption from federal income tax as an organization described in section 501(c)(4) of the Code, because your net earnings inured to the benefit of a private shareholder or individual.

To qualify as an organization described in section 501(c)(4) of the Code no part of an organization's net earnings may inure to the benefit of any private shareholder or individual. The words "private shareholder or individual" in section 501(c)(4) refers to persons having a personal and private interest in the activities of the organization.

You were formed, funded, and controlled by LLC. With the exception of \$487 in interest, LLC provided all of your funding. Although you had three officers, Officer 1, an LLC employee, controlled your assets by virtue of his authority to approve all of your expenditures. See *United Cancer Council, Inc. v. Comm'r, supra*, which holds that the reality of control rather than an insider's place in a formal organizational chart should govern.

In *Livernois Trust v. Commissioner, supra*, the court held that payments by corporations to a trust that controlled them, recorded as a loan and evidenced by unsecured notes bearing 6% interest but on which no interest and no significant payments of principal had been paid to or demanded by the corporations did not represent bona fide indebtedness.

In your application, you state that you borrowed \$y from LLC and that upon dissolution you transferred your remaining assets, \$637,000, to LLC as partial repayment of the loan.

As noted in *Livernois Trust v. Commissioner, supra*, in determining whether a bona fide loan exists, related party transactions between a corporation and the party that controls it must be subject to the closest scrutiny. You are effectively controlled by LLC. The \$y transfer from LLC to you lacks the characteristics of a bona fide loan: the funds were transferred without security, there was never an expectation of full repayment, no significant payments of principal were made, a nominal rate of interest was charged, and there was no specified date at which repayment was required. Further, the document memorializing the 'loan' was incomplete,

undated, and unsigned. Thus, the \$y transferred to you by LLC was not a bona fide loan, rather, it was a contribution. As further evidence that the \$y was never intended to be a loan, you state in your submission that all large State make loan agreements with their major contributors to be able to refund their unused contributions.

During the period in which you were in existence, you transferred to LLC \$29,596 in what you term as interest on the 'loan'. At the time you determined that you had accomplished your purpose and decided to terminate, you chose to transfer your remaining assets, \$637,000, to LLC. In essence, you returned to LLC that portion of its contribution that you no longer needed. In total, you returned to LLC \$666,596 of its contribution.

Similar to the organization in *Church of Eternal Life & Liberty v. Commissioner, supra*, which was controlled by its founder and major contributor, your distribution of \$666,596 inured to LLC.

CONCLUSION:

You do not qualify for recognition of exemption from Federal income tax under section 501(c)(4) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE, SE:T:EO:RA:T:

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Karen Schiller
Acting Director, Exempt Organizations
Rulings and Agreements